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CHARLES ELMORE

IN THE

Supreme Court of the United States

OCTOBER TERM, 1928.

No. 335.

COMPAÑIA GENERAL DE TABACOS DE FILIPINAS,
Petitioner,

v.

COLLECTOR OF INTERNAL REVENUE,
Respondent.

On Writ of Certiorari to the Supreme Court of the Philippine Islands.

BRIEF FOR THE PETITIONER.

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THE OPINIONS IN THE COURTS BELOW.

The opinions of the Supreme Court of the Philippine Islands in this case are not yet reported in the official Philippine reports, but are reported in Volume XXVI, Philippine Official Gazette, No. 65, May 31, 1928, pp. 1712, *et seq.* They are also printed in full in the record herein, the opinion of the court at pages 26-33 and the dissenting opinions of Justice Johnson and Justice Street at pp. 40-59.

The opinion of the Court of First Instance is not reported but is printed in the record herein at pp. 13-18.

THE JURISDICTION OF THIS COURT.

This case is before this court on a writ of certiorari to the Supreme Court of the Philippine Islands granted October 22, 1928, on a petition for certiorari filed by the petitioner on August 7, 1928, under section 7 of the Act of February 13, 1925, c. 229, 43 Stat. 936, 940. The final judgment of the Supreme Court of the Philippine Islands was entered on February 9, 1928 (R. 60). The case involves the construction of section 10 of the Philippine Income Tax Law as applied to foreign corporations (the petitioner being a corporation of Spain) doing business in the Philippine Islands and in the United States, the precise question being whether income derived by the petitioner from sales "made in the United States"—of products of the Philippine Islands produced or purchased by the petitioner in the Philippine Islands and exported to the United States—is income derived from "sources within the Philippine Islands" and therefore taxable under the Philippine Income Tax Law.

STATEMENT OF THE CASE.

The petitioner, Compañia General de Tabacos de Filipinas, is a corporation of the Kingdom of Spain, duly licensed to do business in the Philippine Islands (R. 2, 8).

October 17, 1925, it filed a complaint in the Court of First Instance of the City of Manila alleging that during 1922 it had exported from the Philippine Islands *and sold in the United States* certain quantities

of sugar and tobacco at a total profit to it of 410,567.99 pesos, Philippine currency; that the defendant, as Collector of Internal Revenue, acting under the Philippine Income Tax Law, had unlawfully and illegally levied and assessed against the petitioner a tax of three per centum on such profits earned on the merchandise "exported and sold by it in the United States of America" in the sum of 12,009.75 pesos, Philippine currency; that the petitioner had paid to the respondent, under instant protest in writing, the said sum of 12,009.75 pesos; that the petitioner's protest against the tax was based upon the grounds (1) that its profits from the sugar and tobacco *sold by it in the United States* were subject to the income tax levied by the United States under the Revenue Act of 1921 as profits derived from sources within the United States by foreign corporations, and (2) that no part of those profits from the sugar and tobacco *sold by it in the United States* was derived from sources within the Philippine Islands; that the petitioner's protest against the payment of the tax was overruled and denied by the respondent, and that the respondent had refused and persisted in his refusal to return to the plaintiff the said sum of 12,009.75 pesos; and the petitioner prayed judgment for the amount so paid. (R. 2-4)

The respondent filed an answer, by the Attorney General, admitting the facts alleged in the petitioner's complaint, except with respect to the amount of the profits upon which the income tax assessed and collected from the petitioner was based, the correct amount being said to be 400,324.85 pesos (R. 4-6). This correction was accepted by the petitioner, by the filing of an amended complaint, the amended paragraph III reading as follows:

"That during the year 1922 plaintiff exported from the Philippine Islands *and sold in the United States* of America certain quantities of centrifugal sugar, manufactured tobacco, copra, and coconut oil, at a net profit to plaintiff of 400,324.85 pesos, Philippine currency."

Thereupon, an agreed statement of facts was filed which is printed at pp. 8-12 of the record herein. Paragraphs I and II recite that the plaintiff is a corporation of the Kingdom of Spain, duly licensed to do business in the Philippine Islands, and that the defendant is the duly appointed, qualified, and acting Collector of Internal Revenue of the Philippine Islands. Paragraphs III, IV, V, VI, VII, and VIII are as follows:

"III. That plaintiff is the owner of several 'haciendas,' sugar and oil mills and tobacco factories located in the Philippine Islands destined to the production or manufacture of tobacco, sugar, copra, and coconut oil for sale therein and in foreign countries; and has been and is still engaged, in the Philippine Islands, in the shipping business and in the buying and selling of tobacco, sugar, copra, and oil and in the exportation of the same, and that its business has been, and is being done mainly in the Philippine Islands.

"IV. That the Philippine branch of the plaintiff corporation on various dates during the year 1922 exported from the Philippine Islands a quantity of centrifugal sugar, of which ten per centum was produced and ninety purchased by it in the Philippine Islands, and which was sold in the United States by the agency therein of the plaintiff's Philippine branch, the sale being subject to confirmation and absolute control as to price and other terms and conditions thereof, by the plain-

tiff's Philippine branch; and that from such transactions on centrifugal sugar during said year 1922, the plaintiff made a profit of Pesos 114,226.80, Philippine currency.

"V. That, likewise, the plaintiff's Philippine branch on various dates during said year 1922, exported from the Philippine Islands a certain quantity of manufactured tobacco produced by it in the Philippine Islands which was sold in the United States by the agency therein of the plaintiff's Philippine branch, the sale being likewise subject to confirmation and absolute control as to price and other terms and conditions thereof, by the plaintiff's Philippine branch, deriving from such transactions a profit of Pesos 296,341.19, Philippine currency.

"VI. That, likewise, the plaintiff's Philippine branch on various dates during the said year 1922, exported from the Philippine Islands a certain quantity of copra and a certain quantity of coconut oil, produced, purchased, or manufactured by it in the Philippine Islands, which were sold in the United States by the agency therein of the plaintiff's Philippine branch, such sales being likewise subject to confirmation and absolute control as to price and other terms and conditions thereof, by the plaintiff's Philippine branch, and that from such transactions on copra and coconut oil the plaintiff suffered losses amounting to Pesos 10,243.14, Philippine currency.

"VII. That deducting the sum of Pesos 10,243.14, the losses mentioned in Paragraph VI of this stipulation, from the sum of Pesos 410,567.99, the aggregate of the profits mentioned in Paragraphs IV and V, there remained a net profit of Pesos 400,324.85.

"VIII. That the said net profit of Pesos 400,324.85, together with other gains, profits, or in-

come were accounted for by the plaintiff on its books of accounts kept in the Philippine Islands as earnings made by and accruing to the Philippine branch, thereby subjecting such profits, gains, or incomes to further business deductions—management expenses, losses, etc."

Paragraphs IX, X, and XI recite that the income tax of 12,009.75 pesos was levied and assessed on the aforesaid net profits of 400,324.85 pesos, under Act 2833 (Philippine Income Tax Law) as amended by Act 2926; that the said tax was paid by the petitioner under instant protest in writing to avoid fines and penalties and distraint; that the petitioner's protest was overruled and denied, and that the respondent had refused and continued to refuse to return the amount thereof to the petitioner. Paragraph XII recited that the parties reserved the right to introduce evidence on any point not covered by the agreed statement of facts and which might be deemed material and necessary.

November 16, 1926, the Court of First Instance rendered a decision in favor of the petitioner. The opinion is printed at pp. 13-18 of the record herein.

December 6, 1927, the case was decided by the Supreme Court of the Philippine Islands, the judgment of the lower court was reversed and the complaint dismissed. The opinion is printed at pp. 20-33 of the record.

A motion for re-hearing (R. 33-39) was denied February 8, 1928 (R. 40). At this time, however, dissenting opinions were filed by Justice Johnson and Justice Street (R. 40-59), Justice Street having previously concurred in the opinion of the court and Justice Johnson having reserved his vote. Final judg-

ment for the respondent was entered on February 9, 1928. (R. 60)

SPECIFICATION OF ERRORS.

(1) The court below erred in not giving to the words "total net income received * * * from all sources within the Philippine Islands" in the Philippine Income Tax Law, the same construction applied to the similar words in the Revenue Acts of 1916 and 1918 by the Attorney General of the United States and the Commissioner of Internal Revenue.

(2) The court erred in construing the words "total net income received * * * from all *sources* within the Philippine Islands" in the Philippine Income Tax Law to mean total net income *received within* the Philippine Islands.

(3) The court erred in giving to the words "total net income received * * * from all sources within the Philippine Islands" a construction that results in subjecting foreign corporations with branch offices in the Philippine Island, exporting Philippine products to the United States, to double taxation on the income derived from the sale of such products in the United States.

(4) The court erred in giving to the words "total net income received * * * from all sources within the Philippine Islands" a construction that results in subjecting foreign corporations, doing business in the Philippine Islands, to burdens greater than those to which domestic corporations engaged in the same business are subjected.

(5) The court erred in holding that the income derived by the petitioner *from the sale in the United States* of Philippine products was income derived from "sources within the Philippine islands" upon the showing that the products were produced or purchased in the Philippine Islands, that the sales

were made in the United States by the agent of the petitioner's Philippine branch "subject to confirmation and absolute control as to price and other terms and conditions" by the petitioner's Philippine branch, and that the income was accounted for as earnings of the Philippine branch.

ARGUMENT THAT THE INCOME IN DISPUTE WAS NOT DERIVED FROM "SOURCES WITHIN THE PHILIPPINE ISLANDS" AND THEREFORE NOT TAXABLE UNDER THE PHILIPPINE INCOME TAX LAW.

As already pointed out in the statement of the case, *supra*, and as heretofore urged in the argument in support of the petition for certiorari, this case presents neatly and clearly, as it was intended to do, the question whether the income of a *foreign* corporation derived *from sales made in the United States* of Philippine products after the export of such products to the United States is income derived from "sources within the Philippine Islands" and therefore taxable under the Philippine Income Tax Law.

Upon that question the following argument is submitted, reserving for discussion under a later heading the suggestion made, for the first time, in the decision of the Supreme Court of the Philippine Islands, that under the agreed statement of facts the sales in question may be said, in fact or in law, actually to have been made in the Philippine Islands.

The following points are made:

(1) That the Philippine Income Tax Law was copied from our Revenue Act of 1916, 39 Stat. 756.

(2) That the words "total net income received • • • from all sources within the Philippine Islands"

as used in Sec. 10 of the Philippine Income Tax Law should be given the same construction that has been given to the words "total net income received * * * from all sources within the United States" in the Revenue Act of 1916.

(3) That the words "total net income received * * * from all sources within the United States" in the Revenue Act of 1916, and the similar provisions in the Revenue Acts of 1917 and 1918, have been construed by the Attorney General of the United States and the Commissioner of Internal Revenue, as applied to foreign corporations, as not including income derived from sales made abroad of products or goods exported from the United States.

(4) That this construction has been ratified and confirmed legislatively by the enactment of the Revenue Acts of 1921 and 1924 and later regulations and rulings of the Treasury Department.

(5) That, aside from its disregard of the construction of the similar language in the Revenue Act of 1916, the decision of the Supreme Court of the Philippine Islands in this case is wrong as a construction of the Philippine Income Tax Law.

(6) The construction placed upon section 10 of the Philippine Income Tax Law by the Court below is a doubtful construction which raises a serious question as to the validity of the tax law, as applied to foreign corporations, under section 3 of the Organic Act of August 29, 1916.

1. The Philippine Income Tax Law was Copied from the Revenue Act of 1916.

That the Philippine Income Tax Law, which is Act 2833, enacted March 7, 1919, Vol. 14, Public Laws, p.

221, was drawn with the Revenue Act of 1916 as a model is apparent upon a comparison of the two acts. This will doubtless be conceded by counsel for the respondent and an extended comparison of the two acts in their entirety is hardly necessary in this brief. The material parts of Section 10 of the Revenue Act of 1916, 39 Stat. 756, and Sec. 10 of the Philippine Income Tax Law (the latter as amended by Act 2926, March 20, 1920, which changed only the rate) are as follows:

"Sec. 10. That there shall be levied, assessed, collected, and paid annually upon the total net income received in the preceding calendar year from all sources by every corporation, joint-stock company or association, or insurance company, organized in the United States, no matter how created or organized but not including partnerships, a tax of two per centum upon such income; and a like tax shall be levied, assessed, collected, and paid annually upon *the total net income received in the preceding calendar year from all sources within the United States* by every corporation, joint-stock company or association, or insurance company organized, authorized, or existing under the laws of any foreign country, including

"Sec. 10. (a) There shall be levied, assessed, collected, and paid annually upon the total net income received in the preceding calendar year from all sources by every corporation, joint-stock company, partnership, joint-account (cuenta en participacion), association, or insurance company, organized in the Philippine Islands, no matter how created or organized, but not including duly registered general co-partnerships (companias colectivas), a tax of three per centum upon such income; and a like tax shall be levied, assessed, collected, and paid annually upon *the total net income received in the preceding calendar year from all sources within the Philippine Islands* by every corporation, joint-stock com-

interest on bonds, notes, or other interest-bearing obligations of residents, corporate or otherwise, and including the income derived from dividends on capital stock or from net earnings of resident corporations, joint-stock companies or associations, or insurance companies whose net income is taxable under this title."

pany, partnership, joint-account (cuenta en participacion), association or insurance company, organized, authorized or existing under the laws of any foreign country, including interest on bonds, notes or other interest bearing obligations of residents, corporate or otherwise, and including the income derived from dividends or net profits subject to the tax established in this subsection."

Except for the substitution of the words Philippine Islands for the words United States, the language is almost identical.

2. Section 10 of the Philippine Income Tax Law Should be Given the Same Construtions as Sec. 10 of the Revenue Act of 1916, and the Similar Provisions in Later Revenue Acts.

It is a familiar rule that contemporaneous construction of a statute by those charged with its execution is entitled to great weight and should not be disregarded or overturned except when clearly erroneous.

Edwards v. Darby, 12 Wheat. 206.
Jacobs v. Pritchard, 223 U. S. 200, 213, 214.
United States v. Cerecedo Hermanos, 209 U. S. 337, 339.
First National Bank v. Missouri, 263 U. S. 640, 658.

Applying the rule to the present case, as we shall

show, the Attorney General of the United States, in a comprehensive opinion dated November 3, 1920 (32 Ops. Atty. Gen. 336), has held that the income of a foreign corporation derived from the sale abroad of merchandise purchased or produced in the United States is not derived "from sources within the United States." That opinion was accepted and followed by the Bureau of Internal Revenue, Treas. Dec. 3111, 4 Cum. Bull. p. 280. The subject was later reconsidered by the Attorney General and the former opinion confirmed on January 21, 1924 (34 Ops. Atty. Gen. 93) as applied to the Revenue Acts of 1916, 1917, and 1918. This was likewise accepted and acted upon by the Bureau of Internal Revenue, Treas. Dec. 3576, III-1 Cum. Bull. p. 211. A full discussion of these opinions and rulings will be found *post*, pages 17-20, of this brief.

It will also be observed that the Revenue Act of 1918, enacted February 24, 1919, 40 Stat. 1057, included what was in effect a legislative definition of the phrase "sources within the United States" as follows:

> "Sec. 233. * * * (b) In the case of a foreign corporation gross income includes * * * all amounts received (although paid under a contract for the sale of goods or otherwise) representing profits on the manufacture *and disposition* of goods within the United States."

Later, in the Revenue Acts of 1921 and 1924, certain changes were made in the law with respect to the taxable income of foreign corporations, as hereinafter explained, *post*, pp. 20-24, but the construction placed on the provision in question, so far as it dealt with goods *purchased* in the United States and sold abroad, was expressly adhered to and ratified.

These rulings of the Attorney General and the approved policy of the Bureau of Internal Revenue, and the legislative ratification thereof by Congress, were all called to the attention of the Supreme Court of the Philippine Islands and disregarded by it in its decision in the present case. It was plainly that Court's duty to accept the construction placed upon Sec. 10 by the Attorney General and the Treasury Department of the United States and its failure to do so—or rather its deliberate adoption of a view diametrically opposed to that adopted in the United States—was error which should be corrected.

The following quotation from Justice Street's dissenting opinion is directly in point:

> "In dealing with a statute adopted by the Philippine Legislature from an Act of Congress we should be careful to take the law with the interpretation placed upon it by competent authority in the United States; and special care should be taken about this in dealing with the intricate matters covered by the income tax laws. Our endeavor should be to cooperate, as far as possible, with the Revenue Department of the United States, in making the operation of these laws just and uniform.
>
> "The opinions of the Attorney General of the United States to which reference has been made sustain the proposition that when merchandise is purchased or produced in one country and sold in another, the place of sale is to be taken as the place of the course of income for the purpose of applying a law such as is under consideration in this case; and it will be noted that the ruling thus made arose upon facts where the conclusion reached was contrary to the interests of the Government revenue,—a circumstance which indicates that probably no strong considerations in

favor of the Government were overlooked." (Record, pp. 58-59.)

3. The Words "Total Net Income Received * * * from All Sources Within the United States" in the Revenue Act of 1916, and the Similar Provisions in the Revenue Acts of 1917 and 1918, Have Been Construed by the Attorney General of the United States and the Commissioner of Internal Revenue, as Applied to Foreign Corporations, as Not Including Income Derived from Sales Made Abroad of Products or Goods Exported from the United States.

The provisions of the Revenue Acts that foreign corporations shall be taxed upon their income "from all sources within the United States" are first found in the Revenue Act of 1916, approved September 8, 1916, c. 463, 39 Stat. 756, which provided:

> "Sec. 10. That there shall be levied, assessed, collected, and paid annually upon the total net income received in the preceding calendar year from all sources by every corporation, joint-stock company or association, or insurance company, organized in the United States, no matter how created or organized but not including partnerships, a tax of two per centum upon such income; and a like tax shall be levied, assessed, collected, and paid annually upon the total net income received in the preceding calendar year *from all sources within the United States* by every corporation, joint-stock company or association, or insurance company organized, authorized, or existing under the laws of any foreign country, including interest on bonds, notes, or other interest-bearing obligations of residents, corporate or otherwise, and including the income derived from dividends on capital stock or

> from net earnings of resident corporations, joint-stock companies or associations, or insurance companies whose net income is taxable under this title."

Prior to 1916, the Revenue Act of October 3, 1913, ch. 16, 38 Stat. 114, 166-181, Sec. G (a), had imposed an income tax on foreign corporations "upon the amount of net income accruing *from business transacted and capital invested within the United States.*"

The object of the change in the law effected by the Revenue Act of 1916 is said to have been to prevent foreign corporations from deriving income from the United States free of tax by virtue of a technical construction of the phrase "business transacted and capital invested" and also to prevent an undue imposition of tax when the activities and property producing the income did not take place or was not situated in the United States. Holmes, *Federal Income Taxes*, 6th Ed. 1925, pp. 395-398. In that work the author says (p. 398):

> "The intention of Congress in the 1916 and subsequent statutes seems to have been to discard the 1909 and 1913 basis of taxing nonresident aliens and foreign corporations, and to make the test of taxability the 'source' or situs of the activities or property which produces the income or from which it is derived. * * * This use of the expression 'sources within the United States' has a more sincere regard for the basic rule that the consideration for taxation is protection of life and property and that the income rightly to be levied upon to defray the burdens of the United States Government is that income which is created by activities and property protected by this Government."

The Revenue Act of 1917, approved October 3, 1917, c. 63, 40 Stat. 300, amended section 10 in some respects but the language quoted above remained unchanged.

The Revenue Act of 1918, approved February 24, 1919, c. 18, 40 Stat. 1057, provided:

> "Sec. 233. * * * (b) In the case of a foreign corporation gross income includes only the gross income from sources within the United States, including the interest on bonds, notes, or other interest-bearing obligations of residents, corporate or otherwise, dividends from resident corporations, and including all amounts received (although paid under a contract for the sale of goods or otherwise) representing profits on the manufacture *and disposition* of goods within the United States."

With respect to the income of foreign corporations, Regulations 33 Revised (Revenue Acts of 1916 and 1917) provided:

> "Art. 64. Taxable Income.—Under section 10 of Title I of the Act of September 8, 1916, as amended, a tax of 2 per cent shall be levied, assessed, collected and paid annually upon the total net income received in the preceding calendar year, from all sources within the United States, by every corporation, joint-stock company or association or insurance company organized, authorized, or existing under the laws of any foreign country.
>
> Art. 65. War Income Tax.—The additional tax of 4 per cent on net income imposed by the Act of October 3, 1917, shall apply to foreign corporations in the same manner as in the cases of domestic corporations, except that it shall apply only to income received from sources within the United States.
>
> Art. 66, Par. 309. Sources Within the United States.—It is not necessary that the foreign cor-

poration shall be engaged in business in this country or that it have an office, branch, or agency in the United States. Liability to the tax attaches with respect to the income, the source of which is in the United States.

Par. 310. 'Source' as here used means the place of the origin of the income."

Regulations 45 (Act of 1918) provided:

Art. 503. Every corporation, domestic, or foreign, not exempt under section 231 of the statute, is liable to the tax. It makes no difference that a domestic corporation may receive no income from sources within the United States. On the other hand, a foreign corporation is taxed only on its income from sources within the United States. See sec. 233 of the statute and article 550. For what the term 'corporation' includes and for the difference between domestic and foreign corporations see section 1 and Articles 1501-1509.

* * * * * * * *

Art. 550. The gross income of a foreign corporation, including an insurance company, means its gross income from sources within the United States, as defined and described in articles 91-93 relating to nonresident alien individuals. The income from business relating to a foreign country which is transacted by a United States branch or agency of a foreign insurance company must be returned as gross income."

August 12, 1920, the Secretary of the Treasury made a request on the Attorney General for an opinion whether, under the Revenue Act of 1918, in five specific cases, certain foreign corporations and partnerships derived income from sources within the United States. The Attorney General's opinion was rendered November 3, 1920, 32 Ops. Atty. Gen. 336. The five cases summarized are as follows:

A corporation of Scotland manufactures or partially manufactures articles in this country which are exported to Glasgow where they are finished at the home mill and sold in England. There is no gross income from sources within the United States within the meaning of the Revenue Act of 1918. Also, the income which may accrue to such corporation in England by the sale in England of logs purchased in the United States is not income from sources within the United States.

Where a corporation in England purchases goods in England and sells them in the United States through a New York corporation, the gross income from such business is income from sources within the United States and is to be estimated in the same way that such income is estimated where both manufacture and sale are had within the United States.

Where an English partnership, whose principal office is at Liverpool, maintains a branch office at Dallas, Texas, which does not make any sales but buys cotton in the United States and ships it to the home office in England for disposition, the gross income from such business is not derived from sources within the United States.

An English partnership having its home office in London maintains a branch office in New York City, in charge of a resident member of the firm in that City. The firm deals in raw furs and its income is derived from commissions on the proceeds from sales of furs consigned to it. The principal function of the New York office is to solicit consignments to the firm at London. Only the income of the partner resident within the United States is taxable.

An English corporation operates a line of steamships between Philadelphia and foreign ports. It has no office in the United States, but consigns its ships to agents at Philadelphia who see to the entry and clearance of the ships and the discharge

and loading of cargoes and supplies, collect such part of the freight as is pre-payable in this country, deduct the agents' disbursements and charges, and remit the balance to the company upon the departure of the vessel. The corporation derives income from sources within the United States on the freight and passenger traffic originating within the United States.

In considering the first case, the Attorney General said:

"No income is derived from the mere manufacture of goods; before there can be income there must be sale; and there is no income from sources within the United States from goods manufactured here unless there is, in the language of section 233 (b), both 'manufacture and disposition of goods within the United States.' The obvious purpose of this section is to tax only income that accrues within the United States. Congress does not attempt to tax profits arising from goods manufactured in this country but sold after being shipped abroad and without being disposed of by the owner in this country. I conclude, therefore, that when Burleigh & Sons manufacture or partially manufacture articles in this country but do not sell or dispose of them until they are taken to Scotland, there is no gross income from sources within the United States within the meaning of the Act."

* * * * * * * *

"By a parity of reasoning I conclude that income which may accrue to Burleigh & Sons in England by sale of logs purchased in the United States is not income from sources within the United States."

The opinion of the Attorney General of November 3, 1920, was adopted and promulgated by the Secre-

tary of the Treasury, in Treas. Dec. 3111, 4 Cum. Bull. p. 280.

July 26, 1923, the Secretary of the Treasury again requested an opinion of the Attorney General with respect to the construction of the Revenue Acts of 1916, 1917, and 1918, as affecting taxation of foreign corporations, in particular, foreign steamship companies in this country. The Attorney General, in an opinion dated January 21, 1924, 34 Ops Atty. Gen. 93, replied that in his opinion, after full consideration, the former opinion of November 3, 1920, is a correct and true interpretation of the Revenue Acts of 1916, 1917, and 1918, with respect to the net income received from all sources within the United States by every foreign corporation, and in particular, by foreign steamship companies.

The Attorney General's opinion of January 21, 1924, was adopted and promulgated by the Secretary of the Treasury in Treas. Dec. 3576, III-1 Cum. Bull. p. 211.

4. The Construction Placed Upon Sec. 10 of the Revenue Act of 1916 (and the Similar Provision in the Act of 1918) by the Attorney General and the Treasury Deparment has been Ratified by the Enactment of the Revenue Acts of 1921 and 1924.

It is clear, upon consideration of the opinions of the Attorney General and the rulings of the Treasury Department, cited *supra*, which as authorities are persuasive in the highest degree, that under the Revenue Acts of 1916, 1917, and 1918 the *manufacture, production*, or *purchase* in the United States by foreign corporations of goods for export and sale abroad are not to be considered as factors in determining the *source* of income.

When the Revenue Act of 1921 was under consideration before its enactment, this rule was criticised by economists on the ground that a law which permitted goods to be *manufactured* or *produced* in the United States by foreign corporations and sold abroad, without liability for the income tax, was economically unsound in that no consideration was given to the fact that the profits of an agricultural or manufacturing business might be due to two practically indivisible factors, (1) efficient producing or manufacturing, and (2) efficient marketing. *Senate Report* 275, 67th Congress, 1st Session.

To meet these objections and criticisms, the Revenue Act of 1921 provided a new method of ascertaining the income of aliens and foreign corporations from sources within and without the United States, in effect creating a new kind of income—income from "sources *partly within* and *partly without* the United States"—and enabling the Government for the first time to tax a part of the gains derived by foreign corporations from sales abroad of goods *produced* or *manufactured* in the United States.

No objection, however, was raised to the rulings under the Acts of 1916, 1917, and 1918, that income derived from the *purchase* of personal property within and its sale without the United States should be treated as derived entirely from the country in which sold, and accordingly the amendments were not drawn to cover the purchase in the United States of goods to be sold abroad. In fact, the rulings were carried into the Act of 1921 (see subsection (e) of Section 217, *post*), and later into the Act of 1924.

The Revenue Act of 1921, c. 136, 42 Stat. 227, provided:

"Sec. 233. * * * (b) In the case of a foreign corporation, gross income means only gross income from sources within the United States, determined (except in the case of insurance companies subject to the tax imposed by sections 243 or 246) in the manner provided in Sec. 217."

"Sec. 217. (a) That in the case of a non-resident alien individual or of a citizen entitled to the benefits of section 262, the following items of gross income shall be treated as income from sources within the United States: * * *

[Including, with certain exceptions, interest on United States obligations, dividends from United States sources, compensation for services performed in the United States, rentals or royalties from property in the United States, profits from sales of real estate in the United States.]

"(b) From the items of gross income specified in subdivision (a) there shall be deducted the expenses, losses, and other deductions properly apportioned or allocated thereto and a ratable part of any expenses, losses, or other deductions which can not definitely be allocated to some item or class of gross income. The remainder, if any, shall be included in full as net income from sources within the United States."

"(c) The following items of gross income shall be treated as income from sources without the United States: * * *

[Interest, dividends, compensation, rentals, and profits similar to those specified in subdivision (a) but derived from sources without the United States.]

"(d) From the items of gross income specified in subdivision (c) there shall be deducted the expenses, losses, and other deductions properly ap-

portioned or allocated thereto, and a ratable part of any expenses, losses, or other deductions which can not definitely be allocated to some item or class of gross income. The remainder, if any, shall be treated in full as net income from sources without the United States.

"(e) Items of gross income, expenses, losses and deductions, other than those specified in subdivisions (a) and (c), shall be allocated or apportioned to sources within or without the United States under rules and regulations prescribed by the Commissioner with the approval of the Secretary.

* * * * * * * *

"Gains, profits and income derived from the purchase of personal property within and its sale without the United States or from the purchase of personal property without and its sale within the United States, shall be treated as derived entirely from the country in which sold."

Regulations 62 (1921 Act) provided:

"Art. 550, Gross Income of Foreign Corporations.—The gross income of a foreign corporation, including a mutual insurance company, means its gross income from sources within the United States, as defined and described in section 217 and Articles 316-328 relating to nonresident alien individuals. As to other foreign insurance companies, see Art. 687. See also Art. 541."

"Art. 316, Income from Sources within the United States.—Nonresident alien individuals, foreign corporations, and citizens of the United States or domestic corporations entitled to the benefits of section 262 are taxable only upon income from sources within the United States. See sections 213 (c), 233 (b), and 262.

"The statute divides the income of such taxpay-

ers into three classes: (1) Income which is derived in full from sources within the United States; (2) income which is derived in full from sources without the United States; and (3) income which is derived partly from sources within and partly from sources without the United States. The taxable income includes that derived in full from sources within the United States and that portion of the income which is derived partly from sources within and partly from sources without the United States which is allocated or apportioned to sources within the United States."

"Art. 323, Sale of Personal Property.—Income derived from the purchase and sale of personal property shall be treated as derived entirely from the country in which sold. The word 'sold' includes 'exchanged' and ordinarily means the place where marketed. This article does not apply to income from the sale of personal property produced (in whole or in part) by the taxpayer within and sold without the United States or produced (in whole or in part) by the taxpayer without and sold within the United States. See article 327 (b)."

5. The Decision of the Supreme Court of the Philippine Islands in This Case is Wrong as a Construction of the Philippine Income Tax Law, Aside from Its Disregard of the Construction of the Similar Language in the Revenue Act of 1916.

This case was tried first in the Court of First Instance of Manila and decided in favor of the petitioner. The decision of Judge Del Rosario is printed at pp. 15-18 of the Record. As heretofore stated, the case was intended to present neatly the question whether the income of a foreign corporation, derived from sales made in the United States of Philippine

products after the export of such products to the United States, is income derived from "sources within the Philippine Islands" and therefore taxable under the Philippine Income Tax Law.

As stated in the decision of the Court of First Instance (R. 15) counsel for the defendant, the Collector of Internal Revenue, contended that the income in dispute was obtained from articles which were *produced, manufactured* or *purchased* in the Philippine Islands, the sales of which, *although made in the United States,* were subject to confirmation and under the control of the petitioner's branch office at Manilla, and that therefore the profits realized were "from sources within the Philippine Islands."

This argument, which confuses the source of a product with the source of income, was likewise adopted by the Supreme Court of the Philippine Islands, which said in its opinion (R. 29):

> "That is to say, the income in question was derived and received from the plaintiff *from the exclusive products of the Phillippine Islands* which were purchased or produced by and through its branch office in the Philippine Islands and which it shipped from the Islands to the United States, where such products were sold in the identical condition in which they were shipped from the Philippine Islands. Hence, it must follow that the net income of the plaintiff as to such products was from sources within the Philippine Islands *where the products were purchased or produced,* and where the plaintiff maintains its branch office for that specific purpose."

The fallacy of this reasoning lies in the assumption that the origin of the *product* determines the origin or source of the *income* or profit earned when

that product is sold, within the meaning of an income tax law containing language such as that of section 10 of the Philippine Income Tax Law or section 10 of the Revenue Act of 1916. The Court of First Instance detected this fallacy and disposed of this argument without difficulty, saying (R. 15-16):

> "While the goods and merchandise mentioned in the agreed statement of facts are considered as sources of income, because it is from them, once sold, exchanged or assigned in payment of a debt, that the incomes proceed, yet said source must be considered remote for the purposes of the assessment of the tax provided in the section of said law which virtually makes a distinction, according as the merchandise has been sold in these Islands or outside thereof.
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> . . . . . .
>
> "The true source of income received by the plaintiff corporation, for the purposes of the application of the law, is not the merchandise itself, but the transaction made concerning it, because so long as the merchandise is not placed on the market and remains stored or deposited in these Islands, they cannot mean any real income, nor net income subject to tax."
>
> . . . . . .
>
> "If the goods mentioned, although produced in these Islands, could not have been converted into cash or receipts representing income but after they are sold in the United States, the income that must be subject to tax, according to said law, was derived from sources which are not within the Philippine Islands, but in the United States, because said sources are not the *goods* produced here, but the *sale* thereof made in America."

The word "sources" as applied to taxable income conveys one idea—the idea of origin. It has been defined by the Treasury Department in Regulations 33 Revised, Art. 66 (Revenue Acts of 1916 and 1917):

> "Par. 310: Source as here used means the place of the origin of the income."

It has also been defined in Office Dec. 651, 3 Cum. Bull. 265, as follows:

> "The source of income means the place of origin, and is not restricted to the place where payment is made, since the place of payment may be arbitrarily selected without relation to the nature of the transaction and is not indicative of the source. Where the income grows out of a business activity in the United States, it is immaterial where actual payment is made."

This court has said that income may be derived from three sources, from capital and or labor and from sale of capital assets. *Stratton's Independence v. Howbert*, 231 U. S. 399, 415; *Doyle v. Mitchell*, 247 U. S. 179, 185; *Eisner v. Macomber*, 252 U. S. 189.

If these are the sources of income, it follows necessarily that in determining whether a particular item of income is from sources within the United States or, as in this case, from sources within the Philippine Islands, we must inquire into the nature and location of the activities or property which produced the income. If the income is from labor or services, the place where the labor or services are performed is decisive; if in the United States the income is from sources within the United States. If the income is from capital, the place where the capital is employed

is decisive; if it is employed in the United States the income is from sources within the United States. If the income is from sale of capital assets, the place where the sale is actually made determines the source of the income. Holmes, *Federal Income Taxes*, 6th Ed. 1925, p. 396.

The income of a corporation engaged in the production or purchase of tobacco, sugar, copra and oil, for sale outside the Philippine Islands, such as petitioner herein, is due to a series of transactions beginning with the decision of petitioner's executive officers in the Philippine Islands to buy or produce tobacco, sugar, copra, or oil; the actual purchase or production of the same; the shipment of these products to the United States and their storage there until sold; the efforts of petitioner's agency in the United States to find a prospective customer; the negotiations with the customer when found; the agreement on terms and prices; the confirmation and ratification by the Manila office; the communication thereof to the purchaser and the delivery and acceptance of the products sold; the collection of the purchase price; the transfer of the proceeds to the petitioner's Philippine branch; and the entry of the income made thereby, in the books of account of petitioner's Philippine branch.

By a forced construction, each and all of these diverse activities may be considered the source or origin of petitioner's income, since if one of these steps were omitted there would necessarily be no income forthcoming. Indeed, we may even go back and assign the original decision of the petitioner's directors in Spain to establish a branch office in the Philippine Islands as the source of petitioner's income, or we may take into consideration the fact that all the income received by

the petitioner in the Philippine Islands eventually finds its way to Spain, where the main office of petitioner is located, and is accounted for in account books kept by the petitioner in that country.

It is respectfully submitted, however, that such is not the sense in which the term "source" is used in section 10 of Act 2833 of the Philippine Legislature, as amended. As used therein, the income of petitioner from a single transaction has only one source, and if that source be in the United States it cannot at the same time be in the Philippine Islands or elsewhere. Out of these multitudinous activities, that should be selected which brings the income from petitioner's property to fruition, and wherever that transaction was consummated, in that place lies the source of petitioner's income. A different construction such as that adopted by the lower court would wipe out the distinction made in the law with regard to the basis upon which the incomes of domestic and foreign corporations are to be taxed, for there can not possibly be a transaction effected in another jurisdiction by a foreign corporation doing business in the Philippine Islands which cannot be linked in some way with a previous or subsequent transaction, the situs of which is in the Philippine Islands.

The fact that these products are *exported* by the petitioner from the Philippine Islands to the United States *for sale in the United States* by the petitioner's agents, cannot be avoided. When they effect sales at prices acceptable to the petitioner, the profits thus realized are derived from sources within the United States and not from sources within the Philippine Islands.

The construction we urge is a construction which

avoids double taxation and which should have been adopted by the Supreme Court of the Philippine Islands, even without regard to the construction placed upon the similar language in our Revenue acts. As stated by the author of a well-known work on income taxes (Holmes, *Federal Income Taxes*, 6th Ed. 1925, at p. 298):

> "The complications of international taxation are so manifold and the burden of double taxation is often so heavy that it is no exaggeration to call the 1916 and subsequent laws emphasizing the source of income as the test of taxability a long step in advance towards international comity in taxation. The evil of double taxation as between the states of this country was deprecated by Mr. Justice Holmes in *Kidd v. Alabama*, 188 U. S. 730, at p. 732, where he said: 'No doubt it would be a great advantage to the country and to the individual states if principles of taxation could be agreed upon which did not conflict with each other, and a common scheme could be adopted by which taxation of substantially the same property in two jurisdictions could be avoided."

While there is nothing in the law in the Philippine Islands or in the United States prohibiting double taxation, or the taxation of income which is already taxed elsewhere, such taxation is contrary to all sound principles, is inherently unjust and unfair, and "ought, wherever possible, to be prevented." *Buck v. Beach*, 206 U. S. 392, 408.

It can be prevented by giving to the phrase "sources within the Philippine Islands" used in the Philippine Income Tax Law, its natural, ordinary, and familiar meaning, sanctioned and adopted in the rulings of the Attorney General and the Treasury Department of the United States.

In the decision of the Supreme Court of the Philippine Islands it is said (R. 28) that apparently the purpose and intent of the Legislature was that a foreign corporation engaged in business in the Philippine Islands should pay the same rate of tax as a domestic corporation, otherwise the foreign corporation would have an advantage over the domestic corporation engaged in the same business. And again (R. 31) that our contention, if sustained, would give a preference to a foreign corporation doing business in the Philippine Islands over a domestic corporation engaged in the same business, to the amount of the three per cent tax upon the income in question.

On the contrary, the result is grossly unfair to foreign corporations doing business in the Philippine Islands, if the construction placed on section 10 by the Supreme Court of the Philippine Islands be allowed to stand. The difference in the deductions granted to domestic corporations and foreign corporations would not correspond to or bear any reasonable relation to the difference in tax. A domestic corporation may deduct from its gross income all the ordinary and necessary expenses paid within the year in the maintenance and operation of its business and property, including rentals pertaining to its agency in the United States. A foreign corporation, however, is limited to the deduction of its expenses in connection with its business and property, including rentals for such property, *within the Philippine Islands.*

This results from the provisions of the first paragraph of Sec. 12, paragraphs (a) and (b) of the Philippine Income Tax Laws, quoted on p. 33 of the brief filed in support of the petition for certiorari.

6. The Construction Placed Upon Section 10 of the Philippine Income Tax Law by the Court Below is a Doubtful Construction Which Raises a Serious Question as to the Validity of the Tax Law, as Applied to Foreign Corporations, Under Section 3 of the Organic Act of August 29, 1916.

Section 3 of the Organic Act of August 29, 1916, c. 416, 39 Stat. 545, guarantees to all persons in the Philippine Islands, including corporations, the equal protection of the laws, also that the rule of taxation in said Islands shall be uniform. If this income tax law is to be construed as the court below has construed it, the result is not only grossly unfair to foreign corporations doing business in the Philippine Islands in competition with local corporations, but in effect denies to such foreign corporations the equal protection of the laws. The petitioner, being admitted to do business in the Philippine Islands, is entitled to carry on such business on equal terms with local corporations and to enjoy the same rights, subject to the same burdens, as are enjoyed and imposed upon all other persons in like situation. It may not be arbitrarily discriminated against without any real or substantial basis therefor.

Southern Ry. Co. v. Greene, 216 U. S. 400
Hanover Fire Insurance Co. v. Carr, 272 U. S. 494
Compania General de Tabacos de Filipinas v. Collector, 275 U. S. 87.

That there is serious doubt as to the validity of section 10 of the Philippine Income Tax Law as construed by the court below, in view of the provisions with respect to deductions set out in paragraphs (a)

and (b) of Sec. 12 of the same law (set out in parallel columns on page 33 of the brief filed in support of the petition for certiorari herein) is well pointed out in the dissenting opinion of Justice Johnson (R. 57-58) as follows:

> "If the doctrine of the majority opinion is the correct interpretation of the law, then domestic and foreign corporations are subjected to unequal burden in accordance with the provisions of paragraphs (a) and (b) of section 12 of the Act 2833. Their allowable deductions are not the same.
>
> "It is well established that a state, or territory authorized to legislate for itself, may regulate the activities of foreign corporations within the state or such territory, but it cannot regulate or interfere with what foreign corporations may do outside.
>
> "The plaintiff was authorized, through its branch office, to do business in the Philippine Islands. **If it chose to do business outside of the** Philippine Islands it had a perfect right to do so and the Philippine Legislature has no authority to place a burden upon the business done outside of the Philippine Islands."

[Citing *Allgeyer v. Louisiana*, 165 U. S. 578; *St. Louis Compress Co. v. Arkansas*, 260 U. S. 346; *Compania General de Tabacos de Filipinas v. Collector, supra.*]

That where there is any doubt as to the proper construction to be placed upon legislation that construction should be adopted which avoids any doubt as to its constitutionality is a familiar rule of construction. *United States v. Delaware & Hudson Co.*, 213 U. S. 366, 407-408; *Matthew Addy Co. v. United States*, 264 U. S. 239-245.

UPON THE AGREED STATEMENT OF FACTS THE SALES FROM WHICH THE INCOME IN DISPUTE WAS DERIVED MUST BE HELD TO HAVE BEEN MADE IN THE UNITED STATES.

As heretofore stated, this case was intended to settle the question whether the income of a *foreign* corporation derived *from sales made in the United States* of Philippine products after the export of such products to the United States is income derived from "sources within the Philippine Islands" and therefore taxable under the Philippine Income Tax Law.

In the decision of the Supreme Court of the Philippine Islands the suggestion is made, apparently as an aid to the conclusion reached, that upon the agreed statement of facts the sales in question may be said, in fact or in law, actually to have been made in the Philippine Islands. This suggestion was adopted by counsel for the respondent in the brief filed herein in opposition to the petition for certiorari.

Paragraph IV of the agreed statement of facts recites (R. 9):

> "That the Philippine branch of the plaintiff corporation on various dates during the year 1922 *exported from the Philippine Islands* a quantity of centrifugal sugar, of which ten per centum was produced and ninety purchased by it in the Philippine Islands, and *which was sold in the United States* by the agency therein of the plaintiff's Philippine branch, the sale being subject to confirmation and absolute control as to price and other terms and conditions thereof, by the plaintiff's Philippine branch; and that from such transactions on centrifugal sugar during said year 1922, the plaintiff made a profit of Pesos 114,226.80, Philippine currency."

Paragraphs V and VI are similar to paragraph IV. It is also recited in paragraph VIII (R. 11) that the net profit in question, with other gains, profits or income, was accounted for on the plaintiff's books of account kept in the Philippine Islands as earnings made by and accruing to the Philippine branch.

In the decision of the court below, the court calls attention to the stipulation that the sales were subject to confirmation in Manila of price, terms, and conditions, and that the earnings were accounted for on the books of account kept at Manila, and says:

> "In other words, no sale was actually consummated until after it was ratified and approved by the local branch, and all profits or incomes from such sales were accounted for by the plaintiff on its books kept in the Philippine Islands as earnings made by and accruing to the Philippine branch."

Again, later in the opinion (R. 32) the court says:

> "In the instant case, the record is conclusive that all of the sources of plaintiff's income in question had their origin in or were derived from its branch office in the Philippine Islands by and through the products of the Philippine Islands, which were purchased or produced by its branch office in the Philippine Islands, and that all of the sales in question were made through its branch office, and that no sale was actually consummated until such time as it was approved by the branch office both as to terms and conditions, and that an account of all such sales made in the United States was rendered to the branch office, together with the proceeds, where a full and complete record was kept and made of all of such transactions."

These two quotations contain all that is said in the decision of the court below to the effect that these sales must be held, in fact or in law, actually to have been made in the Philippine Islands.

Counsel for the respondent has used this language as a basis for the argument in the brief filed in opposition to the petition for certiorari, that the only question in this case is whether the sales were made in the Philippine Islands or in the United States, and that upon that question the court below has made a finding —as a finding of ultimate facts—that the sales were actually made in the Philippine Islands, and that that finding should not be disturbed by this court.

On the contrary, the whole opinion of the court below shows beyond any question that the actual ground of decision was the same ground on which the case had been defended in the Court of First Instance and was defended in the Supreme Court of the Philippine Islands.

Immediately following the remark that no sale was actually consummated until after ratification by the local branch, the court below continues (R. 29) that it is further stipulated that the products in question were exclusively the products of the Philippine Islands from whence they were shipped to the United States and there sold in the same form and condition as when they were shipped from the Philippine Islands, and then says:

> "That is to say, the income in question was derived and received by the plaintiff *from the exclusive products of the Philippine Islands* which were purchased or produced by and through its branch office in the Philippine Islands and which it shipped from the Islands to the United States,

> where such products were sold in the identical condition in which they were shipped from the Philippine Islands. Hence, it must follow that the net income of the plaintiff as to such products was from 'sources within the Philippine Islands' *where the products were purchased or produced* and where the plaintiff maintains its branch office for that specific purpose."

The fallacy of this reasoning, which confuses the source of a product with the source of income and assumes that the origin of the product determines the origin or source of the income or profit earned when that product is sold, is demonstrated in the decision of the Court of First Instance quoted, *supra*, p. 26, and the argument heretofore submitted in this brief, pages 24-31. Also in the dissenting opinion of Justice Johnson of the Supreme Court of the Philippine Islands (R. 40-58).

Assuming that title did not pass to the purchasers until after ratification of the sales by the Manila office, the sales were no less made in the United States. "A contract of sale is considered as made at the place where the transaction is finally consummated by delivery and acceptance." 35 Cyc. 94. These products were physically in the United States when the sales were made and were delivered and accepted in the United States. There was no executed contract of sale until delivery was made and accepted.

This suggestion in the opinion of the court below with respect to the place of sale is well answered by Justice Johnson in his dissenting opinion (R. 53-56) in part as follows:

> "From the foregoing we are led to the question where were the merchandise involved in this question sold? We find the answer to that question

(1) in the stipulated facts (paragraphs 4, 5, 6 of the stipulated facts), and (2) in the brief of the Attorney-General (p. 6). Said paragraphs of the stipulated facts expressly provide that the merchandise from which the income in question arose 'was sold in the United States.' The Attorney-General in his brief, at page 6, also makes the statement that: 'It is true that the sale of the articles was made in the United States.' In our opinion it would be a great injustice to the appellee if the stipulation presented at the beginning of the trial and the admission of the Attorney-General after the trial should be construed now to the prejudice of the appellee. We do not believe, in view of said stipulation and admitted fact by the Attorney-General, that any question should be raised at this time as to the place of the sale. The question of the place of the sale has been admitted to be in the United States.

It is argued, however, in the majority opinion that inasmuch as the sale was by an agent in the United States, 'the sale being subject to confirmation, etc., as to price and other terms and conditions,' that the sale was not made in the United States according to the stipulated facts, but was made in fact in the Philippine Islands. We cannot give our assent to that argument. The sale took place, by agreement of the parties, where the goods were, in the United States at the time of the sale.

In effect the act has also been construed by the court below as imposing a tax on the income of a foreign corporation *received within* the Philippine Islands. The law does not say that. The law says "income received from *sources* within the Philippine Islands." The remittance of the purchase money to Manila is immaterial. The court below has undertaken to amend the law—not to construe it.

Compare the decision of the Board of Tax Appeals

in the case of *Standard Marine Insurance Co., Ltd.*, 4 B. T. A. 853, where it was held that the interest on Anglo-French bonds and British bonds owned by a foreign corporation but held in the United States by its United States branch, the interest being paid in the United States to the United States branch, is not income from sources within the United States under the Revenue Act of 1918. Compare, also, the ruling of the Bureau of Internal Revenue, 3 Cum. Bull. 265, quoted, *supra*, p. 27, that the source of income is not restricted to the place where payment is made, as the place of payment may be arbitrarily selected without relation to the nature of the transaction and is not indicative of the source.

Nor does not the fact that final ratification of the sales had to be made in Manila transform the sales actually made in the United States into sales made in the Philippine Islands. Ratification is inherent in most sales made through agents and does not change the place of sale for the purpose of taxation. These products were admittedly exported from the Philippine Islands to the United States, were physically in the United States, the petitioner's agents who sought and found purchasers and effected the sales were in the United States, the purchasers were in the United States, delivery was made and accepted in the United States. It would be doing violence to the admitted facts, as well as to the stipulation of the parties, to conclude—as the court below is said to have concluded—that the necessity of ratification by the Manila office of the price and terms and conditions of sale had the effect—notwithstanding the stipulation of the

parties—of making the place of sale for the purpose of taxation in Manila.

Respectfully submitted,

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